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In The

SUPREME COURT OF THE UNITED STATES

No. 75-138

WARREN YEOMANS, ALBERT SCHUHOLZ, WAYNE K. ALLEN, SANDRA ALLEN, DONNA LUX, DONALD GARRETT, ANN GARRETT, MELVIN FORSYTH and ROSEMARY FORSYTH,

Petitioners,

vs.

COMMONWEALTH OF KENTUCKY, KENTUCKY DEPARTMENT OF BANKING AND SECURITIES, KENTUCKY DIVISION OF SECURITIES, STATE OF OHIO, OHIO DEPARTMENT OF COMMERCE, and OHIO DIVISION OF SECURITIES,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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In The

SUPREME COURT OF THE UNITED STATES

No. ————

WARREN YEOMANS, ALBERT SCHUHOLZ, WAYNE K. ALLEN, SANDRA ALLEN, DONNA LUX, DONALD GARRETT, ANN GARRETT, MELVIN FORSYTH and ROSEMARY FORSYTH,

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COMMONWEALTH OF KENTUCKY, KENTUCKY DEPARTMENT OF BANKING AND SECURITIES, KENTUCKY DIVISION OF SECURITIES, STATE OF OHIO, OHIO DEPARTMENT OF COMMERCE, and OHIO DIVISION OF SECURITIES,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PROCEEDINGS BELOW

This Petition seeks review of *Yeomans* v. *Commonwealth of Kentucky*, 515 F.2d 993 (6th Cir. 1975), affirming *Yeomans* v. *Department of Banking & Securities*, No. C1-74-284, S.D. Ohio, W.Div., filed July 11, 1974,[1] both appended hereto.

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[1] The opinion of the District Court was originally entered in *Mathews* v. *Fisher*, S.D. Ohio, W.Div., Civil Action No. 8482, on April 16, 1974,

JURISDICTION

The order sought to be reviewed is dated and was entered by the United States Court of Appeals for the Sixth Circuit on April 28, 1975. No rehearing nor extension of time within which to petition for certiorari was sought nor granted.

Jurisdiction is conferred upon this Court to review the judgment in question by 28 U.S.C. § 1254 (1).

QUESTIONS PRESENTED

I. Should the conflict between the decisions rendered by the United States Courts of Appeals for the Sixth and Second Circuits be resolved by reversing the holding of the Sixth Circuit below that the Secruities Act of 1933 and the Secruities Exchange Act of 1934 fail to reveal a Congressional purpose to make it possible for a citizen to sue a state for violations of the Federal securities laws, and by adopting the holding of the Second Circuit in *Forman* v. *Community Services, Inc.*, 500 F.2d 1246 (1974), cert. granted sub nom. *The State of New York* v. *Forman*, No. 74-647, that the legislative history dispels any doubt that the Federal securities laws were intended to reach the states and their agencies?

II. Where citizens assert claims in District Court against the Commonwealth of Kentucky and certain of its agencies,

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as an order granting the motion to dismiss the claims of the Petitioners herein against Respondents. These claims were severed from Civil Action No. 8482 and designated Civil Action No. Cl-74-284 on July 1, 1974, wherein final judgment on this order was entered on July 11, 1974.

alleging that they have gone beyond regulation of a securities issuer and that the state has itself participated in federally prohibited acts, communicating to purchasers of securities by mail, newspapers and television information which the state knew was false, misleading, and which would be relied upon by securities purchasers, does the Eleventh Amendment of the Constitution of the United States extend to the state immunity to such suit?

III. Where citizens assert claims in District Court against the State of Ohio and the Commonwealth of Kentucky and certain of their agencies, alleging state regulation of an issuer of securities in conflict with federal law, does the immunity of the Eleventh Amendment of the Constitution of the United States insulate from liability as an aider and abettor or controlling person of federal securities law violations:

A. The Commonwealth of Kentucky when it knowingly grants the necessary authorization for interstate sales of unregistered securities, misrepresents the financial condition of the issuer and the issuer's obligations to the securities holders, and makes false representations of the State's involvement in the business of the issuer; and

B. The State of Ohio and the Commonwealth of Kentucky when they fail to enforce their own laws to prevent known violations of federal securities laws and they prevent disclosure of the violations to the purchasers or the Securities and Exchange Commission?

IV. Are citizens entitled to an evidentiary hearing on the facts of implied waiver of immunity by the conduct of the State of Ohio and the Commonwealth of Kentucky?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Constitution of the United States:

AMENDMENT 11

Suits against states—Restriction of judicial power.—The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

15 U.S.C. § 77r:

77r. State control of securities.—Nothing in this title [§§ 77a-77aa of this title] shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person. (May 27, 1933, c. 38, Title I, § 18, 48 Stat. 85.)

15 U.S.C. § 78bb(a):

78bb. Effect on existing law.—(a) The rights and remedies provided by this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3 —78hh of this title] shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any state over

any security or any person insofar as it does not conflict with the provisions of this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or the rules and regulations thereunder.

The more pertinent statutes are set forth above. The texts of other statutes and regulations are included in the Appendix.

STATEMENT OF THE CASE

This action arises out of the sales of securities of the Harmony Loan Company of Kentucky ("Harmony Loan"). The claims charge violations of the non-registration and anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").

The jurisdiction of the District Court was invoked pursuant to section 22 (a) of the Securities Act, 15 U.S.C. § 77v (a), section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. §§ 1331 and 1337.

The claims charge violations of section 12 (1) of the Securities Act, 15 U.S.C. § 77 1 (1), section 12 (2) of the Securities Act, 15 U.S.C. § 77 1 (2), section 15 of the Securities Act, 15 U.S.C. § 77o, section 17 (a) of the Securities Act, 15 U.S.C. § 77q (a), section 10 (b) of the Exchange Act, 15 U.S.C. § 78j (b), and Rule 10b-5, 17 C.F.R. § 240.10 b-5, promulgated thereunder, and section 20 of the Exchange Act, 15 U.S.C. § 78t.

The Petitioners are citizens of Ohio, Kentucky and other states who brought this action on behalf of themselves individually and as representatives of a class of all who purchased the non-voting shares of Harmony Loan ("Investors"), against all who participated in or aided and abetted securities law violations in connection with these sales of

securities. The Investors brought their action by intervening, with leave of court, in the case of *Mathews* v. *Fisher,* Civil Action No. 8482, an action between the former and present owners of the voting stock of Harmony Loan which arose out of the facts and issues upon which the Investors' claims are based.

The Investors, in their complaint, alleged acts engaged in by the Commonwealth of Kentucky and certain of its agencies ("Kentucky") which constituted violations of the federal securities laws. The Investors also alleged acts by the State of Ohio and certain of its agencies ("Ohio") which also, but to a lesser degree, constituted such violations. Kentucky and Ohio (the "States") were joined as Defendants as participators and aiders and abettors of the federal securities law violations. They are the Respondents herein.

The District Court dismissed the claims against the States summarily in response to motions from the States asserting immunity to suit for federal securities law violations by virtue of the Eleventh Amendment of the Constitution of the United States. The District Court severed the claims against the States from Case No. 8482, designated them Case No. Cl-74-284,[2] and entered final judgment of dismissal. On appeal, the United States Court of Appeals for the Sixth Circuit affirmed.

This petition presents for review the question of a state's amenability to suit under the federal securities laws and the right of the Investors to a factual determination on the allegations of implied waiver of Eleventh Amendment immunity, if such immunity exists in federal security law cases.

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[2] The pleadings in the record of Case No. Cl-74-284 still bear the style of Case No. 8482.

The Facts

Harmony Loan operated as a licensed petty loan company in Newport, Kentucky from 1960 to 1972, when, unable to pay the interest on its outstanding debentures, it petitioned for bankruptcy. Throughout its existence, most of the company's loan business involved the paying of the purchase money for used cars and furniture sold by businesses owned by Harmony Loan's principals. The inadequately secured debts of the customers, most incapable of paying, were accumulated as assets on the company's books. The income of the company was almost exclusively the proceeds from sales of securities.

In marketing its securities, Harmony Loan directed its solicitations to the savings and loan market, inducing the depositors by promises of higher interest. It used the words "certificates," "savings," and "bank" regularly in advertising. Its salesmen would promise "withdrawal of savings on 90-day notice." For eleven years, it marketed its five- and ten-year subordinated debentures, preferred and non-voting common stock on this basis to residents of Ohio and Kentucky. The securities were not registered with the Securities and Exchange Commission.

The Investors' complaint charged violations of the federal securities laws, both of their anti-fraud and registration provisions. It charged not just the principals of the issuer, but the officers and directors, accountants and lawyers, and all those who participated in, controlled, or aided and abetted the violations. The States of Kentucky and Ohio were among the charged violators. Some defendants answered. Several filed motions to dismiss. The District Court upheld the complaint against all but the States, dismissing the action as to them.

The allegations in the complaint included the States with other defendants who, while aware of the fraud be-

ing perpetrated, or who were in positions to control the principal violators, committed acts which facilitated the securities law violations. In addition, the claims against the States were supplemented with exhibits of documents from the files of the Kentucky Division of Securities which supported the allegations that the States had culpable knowledge of the violations, and in addition disclosed affirmative acts by the State of Kentucky which facilitated the violations.

The files of the Division show that Kentucky approved newspaper and television advertising containing the language "your savings earn 50% or more at Harmony Loan Co." and "under state banking supervision," that, for a fee charged to the company, the State audited Harmony's books and issued letters to the company, which the company reprinted in solicitation brochures, stating that all necessary information was reviewed and that the company was operating within the law; that it induced the company to pay some of the complaining investors on the oral promises to prematurely redeem debentures, and that it communicated false information directly to a chamber of commerce that was receiving inquiries about the company.

Correspondence between the Ohio and Kentucky Divisions support the allegations that Ohio and Kentucky were for many years aware of the self-dealing with Ohio businesses of the principals and the interstate sales of securities. Throughout all of this, Kentucky continually authorized new security issues, and issues greatly in excess of the debt limit in the company's articles of incorporation. Kentucky further approved prospectuses which omitted material facts about the company which were disclosed in the files of the Division of Securities. Neither State acted to prevent the fraud and other violations or to inform the investors or the Securities and Exchange Commission.

The States filed no answers denying the above facts nor exhibits or other evidence to rebut them. In considering the States' motions to dismiss, the District Court properly took the facts put forth by the Investors as true. The States argued only that, as a matter of law, they are immune, and have done nothing to waive this immunity. This is the position of the States that was adopted by the District Court and the Court of Appeals below.

REASONS TO ALLOW WRIT

This action involves an important question of federal law which has not, but should be decided by this Court: Whether, and under which circumstances, Congress intended in enacting the Securities Act of 1933, 15 U.S.C. § 77a et seq., and the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq., to render the States liable and amenable to suit in federal court for their violations of these acts.

The first question presented by the Petitioners and the threshold question involved here is whether Congress intended to prevent securities fraud from being committed by the States. This question the United States Courts of Appeals for the Second and Sixth Circuits have decided differently, in direct conflict with each other; *Forman* v. *Community Services, Inc.*, 500 F.2d 1246 (2d Cir. 1974), cert. granted sub nom. *The State of New York* v. *Forman*, No. 74-647; and the Court below in this action, *Yeomans* v. *Commonwealth of Kentucky*, 515 F.2d 993 (6th Cir. 1975). The Second Circuit in *Forman* held that the federal securities laws were intended to reach the States. The Sixth Circuit below held that they were not.

Equally important are the second and third questions presented in this petition in that they involve the limits of the States' immunity under the Eleventh Amendment of

the Constitution of the United States to securities fraud claims, and to the kind and degree of conduct that will constitute an implied waiver of whatever immunity might otherwise exist. These questions involve application of the decisions of this Court in *Edelman* v. *Jordan,* 415 U.S. 651 (1974), *Employees* v. *Missouri Public Health Dept.,* 411 U.S. 279 (1973), *Parden* v. *Terminal R. Co.,* 377 U.S. 184 (1964), and *Petty* v. *Tennessee-Missouri Bridge Comm'n.,* 359 U.S. 275 (1959), to the area of interstate commerce regulated by Congress under the federal securities laws.

This case involves two States, Ohio and Kentucky, as defendants, each claimed to have acted differently in waiving its immunity, one affirmatively, one passively. Thus, this case presents this Court with an opportunity to settle a question of law on facts diverse enough to guide the district courts in the many cases which have arisen since investors recovered from the State of Illinois in *Tcherepnin* v. *Franz,* No. 64C1285 (N.D. Ill., March 11, 1973), modified in consent order, (October 9, 1973).

The Conflict Between the Second and Sixth Circuits

The Court of Appeals below relied upon its prior holding in *Brown* v. *Commonwealth of Kentucky,* 513 F.2d 333 (6th Cir. 1975), that:

> "Our examination of both the Securities Act of 1933 and the Securities Exchange Act of 1934 totally fails to reveal 'a purpose of Congress to make it possible for a citizen of that State or another State to sue the State in federal courts' [quoting *Employees* v. *Missouri Public Health Dept.,* 411 U.S. 279, 285 (1973)]." 513 F.2d 333 at 336.

This holding expressly rejected the arguments of the in-

vestors that the States are "persons" within the meaning of the federal securities laws. These laws provide that, for example:

> "It shall be unlawful *for any person,* directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j (b). (Emphasis added.)

And Similarly:

> "(a) It shall be unlawful *for any person* in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —
>
> "(1) to employ any device, scheme, or artifice to defraud, or
>
> "(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q (a). (Emphasis added.)

The Court below apparently disregarded the legislative

history before it defining "person" within the meaning of the act:

> "It includes within the concept of 'person' a government or subdivision thereof, although later sections of the bill exempt from its provisions securities issued by the United States, a state, or a territory or any subdivision of these governmental units." H.R.Rep. No. 85, 73d Cong., 1st Sess. 11.

But the Second Circuit, in *Forman* v. *Community Services, Inc.*, 500 F.2d 1246 (1974), considered this legislative history and arrived at a decision opposite to that of the Sixth Circuit below:

> "Were there any doubt that the [federal] securities laws were intended to reach states or their agencies, the legislative history dispels it. See H.R.Rep. No. 85, 73d Cong., 1st Sess. 11." 500 F.2d 1246, 1256-57.

It is submitted that the Second Circuit's analysis is more consistent with the intent of Congress and this Court's reasoning in *Edelman* v. *Jordan*, 415 U.S. 651 (1974).

Kentucky and Ohio Have Waived Their Immunity By Their Conduct

The Investors here claim, and seek the opportunity to prove, that the States of Kentucky and Ohio have voluntarily entered the area of conduct regulated by the federal securities laws, and in doing so have thereby waived immunity to any suit provided by Congress for violations of those laws. *Parden* v. *Terminal R. Co.*, 377 U.S. 184 (1964).

The Investors claim that when Kentucky voluntarily made representations for communication to purchasers of Harmony Loan securities, and allowed its name to be used in a misleading manner, and performed other acts beyond

those of a regulatory nature, that Kentucky waived what immunity it might have had.

Further, the Investors claim that Kentucky knowingly performed regulatory acts which facilitated violations of federal law. Kentucky approved, and even required, acts by Harmony Loan which violated federal law. The Court below held that conduct arising out of governmental regulation is an immunity clothed function. But the Court below gave no weight to the argument that state regulation which Congress has forbidden under its commerce clause power cannot support state immunity. The pertinent Congressional language is the following:

> "* * * Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any state over any security or any person *insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.*" 15 U.S.C. § 78bb (a). (Emphasis added.)

The State has asserted immunity based on a governmental function which is not properly the State's.

While Kentucky has committed affirmative acts from which a waiver of immunity can be implied, both Ohio and Kentucky have committed passive acts which it is contended constitute waiver of immunity under the circumstances. Both States, with knowledge that federal securities law violations were occurring, refused to invoke their regulatory powers to prevent them, and did nothing to inform the public or the Securities and Exchange Commission.

The alleged acts of waiver of immunity by the States, it is submitted, are fact questions, and in the least, an evidentiary hearing was required in the District Court. The States filed neither answers nor exhibits to contest the factual allegations of the Investors.

SUMMARY

This case, together with the *Forman* case (*Forman* v. *Community Services, Inc.*, 500 F.2d 1246 (1974), cert. granted sub nom. *The State of New York* v. *Forman*, No. 74-647), concerns the application of the Eleventh Amendment immunity of states to claims by citizens under the federal securities laws. Both cases include the issue of the intent of Congress in including the states within the definition of "person" as used in the federal securities laws, an issue which the Sixth Circuit below and the Second Circuit in *Forman* resolved by diametrically opposing interpretations. Should this Court affirm *Forman* on this issue, this action should be reversed and remanded.

The present case, unlike the *Forman* case, includes a wide range of factual occurrences from which a waiver of immunity by the State can be implied. It is submitted that this Court should grant certiorari to settle the issue of what constitutes a state's implied waiver of immunity to suit under the federal securities laws, an issue which has arisen in the district courts in at least five circuits in the past two years. On this issue, it is submitted that an evidentiary hearing on the facts of waiver should be provided by the district court before summary dismissal of the claims against the States.

WHEREFORE, it is respectfully requested that a writ of certiorari be granted on this petition.

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

Civil Action No. 8482
(Filed April 16, 1974)

No. C-1-74-284
(Filed July 11, 1974)

JAMES J. MATHEWS, et al.,
Plaintiffs,

vs.

HAROLD FISHER,
Defendant,

vs.

GEORGE HEITZLER, et al.,
Third Party Defendants,

vs.

WARREN YEOMANS, et al.,
Intervening Plaintiffs,

vs.

HABANA CIGAR CORPORATION, INC., et al.,
Additional Defendants.

ORDER GRANTING MOTIONS OF (The States and State Government Agencies) DEPARTMENT OF BANKING AND SECURITIES, COMMONWEALTH OF KENTUCKY; DIVISION OF SECURITIES, COMMONWEALTH OF KENTUCKY; DEPARTMENT OF COMMERCE, STATE OF OHIO; DIVISION OF SECURITIES, STATE OF OHIO; COMMONWEALTH OF KENTUCKY; STATE OF OHIO TO DISMISS THE INTERVENING PLAINTIFFS' SECOND AMENDED COMPLAINT AND CROSSCLAIMS AS TO SAID "ADDITIONAL DEFENDANTS."

The second amended complaint of the intervening defendants sets forth claims on behalf of investors in a Kentucky Small Loan Company. The claims are stated against a great number of individuals and entities.

These claims are based on alleged violations of the Securities Act of 1933 [15 U.S.C. 77 (v)] and of the Securities Exchange Act of 1934 [15 U.S.C. 78 (aa)] and of Rules of the S.E.C. promulgated thereunder, particularly 10-B and 10-B-5.

The claims against the moving parties are set forth in paragraphs 46 and 47 of the second amended complaint.

Succinctly, the investors claim that the moving states have, both before and after the 1933 and 1934 Federal Acts, adopted state laws calling for the regulation and examination of small loan companies and devolved that responsibility on the moving state agencies; that the state agencies failed to do what the laws required, though they represented to the public that they had (or permitted the loan company involved so to do) ; that the agencies knew or should have known that many state and federal laws were being violated by the loan company in its offerings; that the agencies knew or should have known that many state and federal laws were being violated by the loan com-

pany in its offerings; that the agencies knew or should have known that the financial condition of the loan company at various pertinent times was misrepresented; that the State and state agencies thereby became "controlling persons" and/or aiders and abettors and are liable to the investors. On a motion to dismiss, it is axiomatic that the Court accept as true the allegations of the second amended complaint. We so do — except for the claim that the Commonwealth of Kentucky has expressly waived immunity applicable to this Court. That is not so.

The question boils down to the liability of a sovereign state which —

(a) enters the securities field for the purpose of regulation (i.e., passes regulatory statutes);

(b) so provides for regulation of matters also regulated by Federal law;

(c) fails to regulate in accord with its own laws, i.e., fails to administer its laws;

(d) as a consequence, fails or neglects to deter actions or omissions by regulated sellers of securities, and/or controlling persons, or permits misrepresentation by such, which constitutes violations of Federal Securities and Exchange laws (as well as state enactments) to the detriment of buyer-plaintiffs.

To perhaps make it a little more specific — a state examines and actually or in effect publishes its examination. Suppose the examinations are such as (a) would require closing down under its own laws; or (b) were so negligently made and published that, if done so by the seller's board, or officers, or accountant, etc., it would result in liability under 10-B-5. The specific — Is the state liable?

The moving parties rest on the Eleventh Amendment, which needs no recitation. The intervening plaintiffs contend, alternately –

(a) that the State has waived immunity by regulating in the securities area, particularly after Congressional legislation has entered the field; and

(b) that the various states should be included within the definition of "persons" in the Federal Securities and Exchange Acts.

Plaintiffs rely heavily on:

Parden v. *Terminal Co.*, 377 U.S. 184 (1964);
Tcheriprin v. *Franz*, N.D. Ill., (1973).

Movants, countering, reply with:

Employees v. *Missouri*, — U.S. —, 36 L.Ed.2d 251;
Barr v. *Kentucky*, W.D. Ky. (1973); and
MacKethan v. *Virginia*, E.D. Va. (1974).

The two Supreme Court cases involved the principle, but not the specific. The three district court cases each involved the specific.

The point is that each – (a) the Federal government and (b) the State governments – has a governmental interest (as distinguished from proprietary interest, i.e., this is not a case involving a sale by the state of its securities) in the purchase and sale of securities. From an economic point of view, the fields cannot be fenced. They overlap (as the multiple qualifications with the S.E.C. and the state counterparts demonstrate). In the view of this Court, neither the entry by the state into an undefined field subject to federal regulation, nor its failure to administer its own laws in that field, furnish any basis for a waiver of

the Eleventh Amendment or a consent to be sued. Nor may such (co-regulation) be the foundation on which to rest a construction of congressional acts to include states as persons — at least where the state action is limited to the strictly governmental.

This Court will follow the Virginia and Kentucky District Courts and, therefore, the motions are granted.

/s/ TIMOTHY S. HOGAN
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

Civil Action No. 8482

JAMES J. MATHEWS, et al.,
Plaintiffs,

vs.

HAROLD FISHER,
Defendant,

vs.

GEORGE HEITZLER, et al.,
Third Party Defendants,

vs.

WARREN YEOMANS, et al.,
Intervening Plaintiffs,

vs.

HABANA CIGAR CORPORATION, INC., et al.,
Additional Defendants.

ORDER GRANTING MOTION OF INTERVENING PLAINTIFFS TO SEVER CLAIMS AND DESIGNATE RECORD OF SEVERED ACTION

(Filed July 1, 1974)

This matter came before this Court on the motion of the Intervening Plaintiffs Warren Yeomans, Albert Schuholz, Wayne K. Allen, Sandra Allen, Donna Lux, Donald Garrett, Ann Garrett, Melvin Forsyth, and Rosemary Forsyth, to sever their claims against the Additional Defendants Department of Banking and Securities of the Commonwealth

of Kentucky, Division of Securities of the Commonwealth of Kentucky, Department of Commerce of the State of Ohio, Division of Securities of the State of Ohio, Commonwealth of Kentucky, and State of Ohio. Intervening Plaintiffs also moved the Court to designate those portions of the record which should constitute the new action. No parties opposed this motion, and all parties appear to be in agreement as to the designation of the record of the action to be severed.

Upon due consideration of the Intervening Plaintiffs' motion, the letter of May 13 from the Commonwealth of Kentucky, its Department of Banking and Securities and its Division of Securities, and Intervening Plaintiffs letter of June 28, 1974, and upon consideration of the record in this action, the Court is of the opinion that the motion is well taken and should be, and hereby is, granted as follows:

1. The claims of the Intervening Plaintiffs Warren Yeomans, Albert Schuholz, Wayne K. Allen, Sandra Allen, Donna Lux, Donald Garrett, Ann Garrett, Melvin Forsyth and Rosemary Forsyth, against the Additional Defendants Department of Banking and Securities of the Commonwealth of Kentucky, Division of Securities of the Commonwealth of Kentucky, Department of Commerce of the State of Ohio, Division of Securities of the State of Ohio, Commonwealth of Kentucky, and State of Ohio, are hereby severed from this action pursuant to Rule 21 of the Federal Rules of Civil Procedure.

2. The Clerk of this Court shall assign a separate docket number to the severed action, which shall be styled Warren Yeomans, Albert Schuholz, Wayne K. Allen, Sandra Allen, Donna Lux, Donald Garrett, Ann Garrett, Melvin Forsyth, and Rosemary Forsyth, Plaintiffs, vs. Department of Banking and Securities of the Commonwealth of Kentucky, Division of Securities of the Commonwealth of Ken-

tucky, Department of Commerce of the State of Ohio, Division of Securities of the State of Ohio, Commonwealth of Kentucky, and State of Ohio, Defendants. This severed action shall remain on the docket of this Court.

3. The record for the severed action is hereby designated, and the Clerk of this Court shall prepare the record for the severed action, to include the following:

(a) The copy of Intervening Plaintiffs' Second Amended Complaint and Crossclaims, which was supplied as Exhibit A with their motion of May 2, 1974.

(b) The originals of those documents in the record of the present action which are listed in Exhibit B of Intervening Plaintiffs' motion of May 2, 1974.

(c) The originals of those documents which are listed on page 2 of the March 13, 1974 letter to this Court from the Additional Defendants Commonwealth of Kentucky and its Division of Banking and Securities and Division of Securities.

(d) Copies of the following documents, to be prepared by the Clerk from originals, which originals shall remain in the record of this action:

(1) The answer of Plaintiffs James J. Mathews, Hannah R. Mathews, Frank Spampinato, Juanita Spampinato; Third Party Defendants, Robert Stone, Joseph Becker, Alvera M. McCarren, Rodney Sands, John Doe a/k/a Mr. Whitecloud, Green Brothers Warehouse Furniture Co., Inc., Newport Furniture, Inc., Thelma Klayman; and Additional Defendants, Habana Cigar Corporation, Inc., Green Brothers Leasing Company, Green Brothers, Inc., Trustee, to the Intervening Plaintiffs' Second Amended Complaint and Cross Claims, filed September 25, 1973.

(2) Motion of Intervening Plaintiffs Warren Yeomans, Albert Schuholz, Wayne K. Allen, Sandra Allen, Donna

Lux, Donald Garrett, Ann Garrett, Melvin Forsyth and Rosemary Forsyth: (1) For Certification Under Rule 54 (b), F.R.Civ.P., Directing the Entry of Final Judgment on the Order of April 16, 1974, Granting Motions of Additional Defendants Department of Banking and Securities and Division of Securities, Commonwealth of Kentucky; Department of Commerce and Division of Securities, State of Ohio; Commonwealth of Kentucky; and State of Ohio, to Dismiss the Intervening Plaintiffs' Second Amended Complaint and Crossclaims as to Said Additional Defendants; (2) For Severance of the Claims of Said Second Amended Complaint Against Said Additional Defendants, Under Rule 21, F.R.Civ.P.; and (3) For a Designation of the Record of the Severed Action, filed May 2, 1974.

(3) Letter of Additional Defendants Commonwealth of Kentucky, Department of Banking and Securities and Division of Securities of the Commonwealth of Kentucky, dated May 13, 1974.

(4) Letter from Intervening Plaintiffs dated June 28, 1974.

(5) This Order.

Accordingly, the second and third branches of the motion relating to severance of the claims is granted. The first branch of the motion, relating to the certification of this Court's April 14, 1974 Order for appeal, shall be ruled upon in the severed action.

SO ORDERED.

/s/ TIMOTHY S. HOGAN, Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

No. C 1 74-284

WARREN YEOMANS
303 North Macomb
Monroe, Michigan 48161

ALBERT SCHUHOLZ
5757 Kenridge Drive
Cincinnati, Ohio

WAYNE K. ALLEN
256 Sugar Camp Road
Ft. Mitchell, Kentucky

SANDRA ALLEN
256 Sugar Camp Road
Ft. Mitchell, Kentucky

DONNA LUX
1603 St. Anthony
Ft. Wright, Kentucky

DONALD GARRETT
687 Skyway Drive
Independence, Kentucky 41051

ANN GARRETT
687 Skyway Drive
Independence, Kentucky 41051

MELVIN FORSYTH
3902 Leslie Avenue
Covington, Kentucky

ROSEMARY FORSYTH
3902 Leslie Avenue
Covington, Kentucky

Plaintiffs

vs.

DEPARTMENT OF BANKING AND SECURITIES
Commonwealth of Kentucky
c/o Hon. Howard T. Sallee
Commissioner
102 Mero Street
Frankfort, Kentucky 40601

DIVISION OF SECURITIES
Commonwealth of Kentucky
c/o Hon. Thomas Jacobs
Acting Director
Frankfort, Kentucky 40601

DEPARTMENT OF COMMERCE
State of Ohio
c/o Dennis Shaul, Director
366 East Broad Street
Columbus, Ohio 43215

DIVISION OF SECURITIES
State of Ohio
c/o Hon. William Case
Commissioner
Columbus, Ohio 43215

COMMONWEALTH OF KENTUCKY
c/o Hon. Thomas Stovall
Secretary of State
Frankfort, Kentucky 40601

STATE OF OHIO
c/o Hon. Ted W. Brown
Secretary of State
Columbus, Ohio 43215

Defendants

ORDER GRANTING PLAINTIFFS' MOTION FOR CERTIFICATION UNDER RULE 54(b), F.R.Civ.P., DIRECTING ENTRY OF FINAL JUDGMENT ON THIS COURT'S ORDER OF APRIL 16, 1974 ORIGINALLY ENTERED IN THE CASE OF MATHEWS, et al. v. FISHER v. HEITZLER, et al. v. YEOMANS, et al. v. HABANA CIGAR CORPORATION, INC., et al., C. A. No. 8482

(Filed July 11, 1974)

This matter came before this Court upon motion of Plaintiffs, as Intervening Plaintiffs in Civil Action No. 8482, for certification under Rule 54 (b), Federal Rules of Civil Procedure, directing the entry of final judgment on this Court's Order of April 16, 1974, which Order granted the motions of the Defendants herein, who were Additional Defendants in Civil Action No. 8482, to dismiss the Intervening Plaintiffs' Second Amended Complaint and Crossclaims as to said Additional Defendants.

The Court's Order of April 16, 1974 and the claims to which that Order related have been severed from Civil Action No. 8482 by Order of this Court, when it granted branches 2 and 3 of Intervening Plaintiffs' motion of May

2, 1974. Branch 1 of that motion, the motion for certification under Rule 54 (b) of the Order of April 16, 1974, is now before this Court and is the subject of this Order.

None of the parties to this action opposed Plaintiffs' motion for certification.

Upon due consideration of the motion, the agreement of the parties as to its propriety, and the record in this action, the Court hereby determines that there is no just reason for delay in directing entry of final judgment in this action on this Court's Order of April 16, 1974, originally entered by this Court in Civil Action No. 8482, granting the motions of the Additional Defendants Department of Banking and Securities and Division of Securities, Commonwealth of Kentucky, Department of Commerce and Division of Securities, State of Ohio, Commonwealth of Kentucky, and State of Ohio, to dismiss Intervening Plaintiffs' Second Amended Complaint and Crossclaims as to said Additional Defendants. The Court is of the opinion that the motion is well taken and should be granted.

Accordingly, branch 1 of Plaintiff's motion of March 2, 1974 is hereby granted. This Court's Order of April 16, 1974 is hereby certified pursuant to Rule 54 (b), Federal Rules of Civil Procedure. It is hereby directed that final judgment on this Court's Order of April 16, 1974 be entered.

SO ORDERED.

/s/ TIMOTHY S. HOGAN, Judge

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 74-2003

WARREN YEOMANS, ALBERT SCHUHOLZ, WAYNE K. ALLEN, DONALD LUX, SANDRA ALLEN, DONALD GARRETT, MELVIN FORSYTH, ANN GARRETT, ROSEMARY FORSYTH,

Plaintiffs-Appellants,

v.

COMMONWEALTH OF KENTUCKY, DEPT. OF COMMERCE, COMMONWEALTH OF KENTUCKY, DEPT. OF BANKING & SECURITIES FOR THE COMMONWEALTH OF KENTUCKY, STATE OF OHIO, DEPARTMENT OF COMMERCE AND DIVISION OF SECURITIES FOR THE STATE OF OHIO,

Defendants-Appellees,

Appeal from the United States District Court for the Southern District of Ohio, Western Division.

Decided and Filed April 28, 1975.

Before: PECK and LIVELY, Circuit Judges, and O'SULLIVAN, Senior Circuit Judge.

PER CURIAM. The appeal before this court involves one issue which was severed from a complicated case now be-

fore the United States District Court for the Southern District of Ohio as an outgrowth of the failure of the Harmony Loan Company of Newport, Kentucky. Plaintiffs-appellants, a group of investors in Harmony Loan, seek to recover from the Commonwealth of Kentucky and the State of Ohio money damages allegedly caused by the States' violations of federal securities laws.[1] Specifically, plaintiffs charge that the defendant States went beyond their regulatory functions and became aiders and abettors or participants in fraudulent activities which resulted in widespread losses to the investors and which exposed other persons to suit by the investors in the court below. The district court granted the defendant States' motions to dismiss on the grounds that the Eleventh Amendment[2] provides complete immunity from suit under the facts in this case That ruling is challenged here.

The facts as they relate to the singular issue herein considered are not complex. Harmony Loan was established in 1960 to engage in the business of providing funds to finance consumer transactions. Funds for the loans were obtained by selling securities to the public, predominantly residents of Kentucky and Ohio. The Commonwealth of Kentucky and the State of Ohio, pursuant to applicable statutes[3] and through their respective agencies, undertook

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[1] Plaintiffs alleged violations of the Securities Act of 1933, 15 U.S.C. §§ 77 *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78 *et seq.*

[2] The Eleventh Amendment:

> "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

[3] Kentucky Securities Act, K.R.S. 292.310 *et seq.*; Ohio Securities Act, O.R.C. 1707 *et seq.*

to regulate the actions of Harmony Loan in connection with the sale of its securities. Harmony Loan became insolvent in 1972, whereupon plaintiffs filed suit against a large number of individuals and entities involved in the sale and distribution of the securities, including the States of Kentucky and Ohio. Defendant States, as hereinabove related, successfully interposed Eleventh Amendment immunity in the district court.

We note at the outset, that neither Kentucky nor Ohio has expressly waived its traditional immunity in this area,[4] and if a waiver is to be found it must be implied. Plaintiffs argue that entry by a state, in its regulatory capacity, into the congressionally regulated area of securities constitutes just such an implied waiver of immunity. This court has specifically rejected that argument.

> "Our examination of both the Securities Act of 1933 an dthe Securities Exchange Act of 1934 totally fails to reveal 'a purpose of Congress to make it possible for a citizen of that State or another State to sue the State in the federal courts.' [Quoting *Employees* v. *Missouri Public Health Dept.*, 411 U.S. 279, 285 (1973).] . . . There is nothing to suggest that either federal act was intended to be or should be construed either to divest [a state] of the power to regulate its state chartered institutions or beyond that, to do so only upon condition of its consent to be sued by one of its own citizens if that power is for any reason improperly exercised."[5] *Brown* v. *Kentucky*, — F.2d —, No. 73-1347 (6th Cir., filed April 2, 1975).

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[4] See Kentucky Constitution, § 231; Ohio Constitution, Art. II, §§ 22 and 29.

[5] *Brown* v. *Kentucky* relies heavily upon *Edelman* v. *Jordan*, 415 U.S. 651 1974).

In *Brown*, plaintiff sought to recover for damages resulting from alleged violations of federal securities laws on the part of the Commonwealth of Kentucky arising from the fraudulent or grossly negligent failure of the Commissioner of Banking and Securities to discover and disclose certain irregularities connected with a state chartered savings and loan association. In the instant case, plaintiffs allege that Kentucky and Ohio regulatory agencies "knowingly or with gross negligence" permitted or failed to prevent violations of both state and federal securities laws. Although couched in different language and arising out of unrelated factual circumstances, the allegations made in the two cases are nearly identical and we perceive no basis for reaching a result other than that reached in *Brown*.

Plaintiffs urge that the defendant States, by their failure to properly regulate in accord with state statutes, went beyond regulation and became aiders and abettors or active participants in the fraudulent activities of Harmony Loan. We fail to see that that theory advances plaintiffs beyond the waiver threshold. Regardless of what the specific allegations may be, the complained of activities of the defendant States arose out of the immunity clothed function of governmental regulation of securities.

Accordingly, the judgment of dismissal as to the Commonwealth of Kentucky and the State of Ohio is affirmed.

STATUTES AND REGULATIONS

15 U.S.C. § 77*l*(1) and (2):

77*l*. Civil liabilities arising in connection with prospectuses and communications.—Any person who—

(1) offers or sells a security in violation of section 5 [§ 77e of this title], or

(2) offers or sells a security (whether or not exempted by the provisions of section 3 [§ 77c of this title], other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission) and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77o:

77o. Liability of controlling persons.—Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under section 11

[§ 77k of this title] or 12 [§77*l* of this title], shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77q(a):

77q. **Fraudulent interstate transactions.**—(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77v.(a):

77v. **Jurisdiction of offenses and suits.**—(a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title [§77a-77aa of this title] and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title [§§ 77a-

77aa of this title]. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendants may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended. No case arising under this title [§§-77a-77aa of this title] and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title [§§ 77a-77aa of this title] brought by or against it in the Supreme Court or such other courts.

15 U.S.C. § 78j(b):

78j. Regulation of the use of manipulative and deceptive devices.—It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78t(a):

78t. Liabilities of controlling persons.—(a) Every person who, directly or indirectly, controls any person liable under any provision of this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or of

any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78aa:

78aa. Jurisdiction of offenses and suits.—The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or rules and regulations thereunder, or to enjoin any violation of such title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh of this title] or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title [§§ 78a-78d, 78e-78*l*, 78m-78o, 78o-3—78hh

of this title] brought by or against it in the Supreme Court or such other courts.

17 C.F.R. 240.10b-5: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."